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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 573

HAROLD C. BOOTH and HENRY J. McCARTHY,
PETITIONERS,

v.

VARIAN ASSOCIATES

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

LOUIS LOSS
Langdell Hall
Cambridge 38, Mass.

C. HENRY GLOVSKY
173 Cabot Street
Beverly, Mass.
Counsel for Petitioners

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

The petitioners pray that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the First Circuit entered on July 15, 1964, which affirmed the judgment entered on December 12, 1963, by the United States District Court for the District of Massachusetts.

Opinions Below

The opinion of the Court of Appeals (R. 47-54) is reported in 334 F.2d 1 and set out in Appendix A, *infra* page

23. The opinion of the District Court (R. 38-42) is reported in 224 F. Supp. 225.

Jurisdiction

The judgment of the Court of Appeals was entered on July 15, 1964 (R. 55). The jurisdiction of this Court is invoked under §1254 of the Judicial Code, 28 U. S. C. §1254, whose predecessor provisions, §§239 and 240, are made applicable by §25(a) of the Securities Exchange Act of 1954, 48 Stat. 901, 15 U. S. C. §78y(a).

Questions Presented

(1) Whether, for purposes of §16(b) of the Securities Exchange Act of 1934, 48 Stat. 896, 15 U. S. C. §78p(b) (which provides in substance that a company with a registered equity security may recapture any profit realized by a director from any "purchase and sale" of the company's stock "within any period of less than six months"), the "purchase" here was made in 1959, when the parties entered into a *mutually binding agreement* for the petitioners' acquisition of a quantity of shares from the respondent in exchange for shares in another company; or whether the "purchase" was made in 1962, when the exchange of certificates was *physically consummated*.

(2) Whether the profit was exempted under the terms of §16(b) in any event on the ground that the security "was acquired in good faith in connection with a debt previously contracted."

Statute Involved

The pertinent provisions of the Securities Exchange Act of 1934, 48 Stat. 881, 15 U. S. C. §78a *et seq.*, are set forth in Appendix B, *infra* page 32.

Statement of the Case

This is an action by a corporation against two of its directors under §16(b) of the Securities Exchange Act of 1934 for recovery of profits from sales of the corporation's shares allegedly made within a period of less than six months after their purchase. The District Court had jurisdiction under §27 of that Act, 48 Stat. 902, 15 U. S. C. §78aa. Section 16(b) is the provision which was before the Court in *Blau* v. *Lehman*, 368 U.S. 403.

Section 16 is simple—though sometimes deceptively so. Section 16(a) requires (among others) every director of a company with an equity security registered under the Act to file monthly reports with the SEC in the event of any change in his holdings of any equity security of the company. Section 16(b) provides, in so far as here pertinent, that any profit realized by a director from any "purchase and sale" of his company's stock "within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer * * *."

The Act contains a partial definition of "purchase" in §3(a)(13), 48 Stat. 884, 15 U. S. C. §78c(a)(13): "When used in this title, unless the context otherwise requires— * * * The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire."

Facts. There are no facts in dispute. Both sides moved for summary judgment, the petitioners raising the two purely legal questions here specified. R. 6, 38.

On January 14, 1959, the two petitioners owned substantially all the outstanding shares of Bomac Laboratories, Inc. On that day they and the six other stockholders of Bomac entered into an agreement, amended on February 26, 1959, whereby they sold 400 Bomac shares to the respondent ("Varian") in exchange for 199,477 of its

shares (R. 17-32). This was 80 percent of Bomac's outstanding shares, and 388 of the 400 shares came in equal amounts from the two petitioners, the six other stockholders supplying the balance of 12 shares. Each of the petitioners was left with half of the 100 shares of Bomac which remained outstanding. Shortly, after this, both were elected to Varian's board of directors.

Pursuant to a second contract of February 26, 1959—the critical contract here (R. 32-38)—the petitioners agreed to exchange their last 100 shares of Bomac for a quantity of additional Varian shares equal in value, on the basis of the market quotations of the day before the closing, to $2,000,000 plus 20 percent of the increase in Bomac's retained earnings between year-end 1958 and the end of the month preceding the closing.

The contract specified July 2, 1962, as the closing date (¶16). But Varian was given the right to accelerate the closing at any time as to all or any part of the 100 shares of Bomac stock (¶2). The petitioners, on the other hand, were given a right to accelerate only on certain conditions limited for the most part to their death or legal incompetency (in which event their legal representatives would be bound to make the exchange) or an involuntary change in their positions as directors or officers of the two companies (¶13). The contract of February 26, 1959, was a firm commitment on both sides, with no conditions of any kind aside from (1) routine cross-warranties as to the valid issuance of both companies' shares and the like, (2) a standard form of investment representation given by the petitioners to comply with the Securities Act of 1933, and (3) an option on their part to refuse to consummate at the closing unless Varian had taken the necessary steps to make the exchange a tax-free reorganization (¶¶4, 5, 13).

Varian accelerated the closing by only three days, from July 2 to June 29, 1962, when the certificates were physically

exchanged. Within less than six months after that date, the petitioners sold some of their shares on the New York Stock Exchange at a profit, over the June 29 market, of $42,895 for Booth and $12,309 for McCarthy.

The Holding Below. The Court of Appeals, through Judge Hartigan, concluded—notwithstanding the partial definition of "purchase" in §3(a)(13) to include normally "any contract to buy"—that the specification of a formula price rather than a fixed price in the mutually binding contract of 1959 precluded the existence of a "purchase" until the physical exchange of certificates at the closing in 1962. The court also construed the "debt" exemption as inapplicable.

Reasons for Granting the Writ

First: The decision below is in conflict, at least in principle, with a line of cases in the Second Circuit which has formulated the test for fixing the date of purchase, "where a choice between executory and executed dates is required," in terms of when the director "incurred an irrevocable liability to take and pay for the stock," which is to say, when his "rights and obligations became fixed." *Blau* v. *Ogsbury*, 210 F.2d 426, 427; *Stella* v. *Graham-Paige Motors Corp.*, 232 F.2d 299, 301, *cert. denied*, 352 U.S. 831 (a contract subject to important conditions precedent is *not* a "purchase" until those conditions are satisfied); see also *Falco* v. *Donner Foundation, Inc.*, 208 F.2d 600, 604; *Silverman* v. *Landa*, 306 F.2d 422 (a director who gives a "put," that is, an option to sell to him, does not become a purchaser of the underlying stock until the "put" is exercised by the optionee); *Blau* v. *Allen*, 163 F. Supp. 702 (S. D. N. Y.); and see generally 2 Loss, *Securities Regulation* (2d ed. 1961, Supp. 1962) 1098-1100.

The Second Circuit, it seems fair to say, has been a

"tough" court in construing §16(b), from the very first case, in which it started with the premise that "the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or shareholder and the faithful performance of his duty." *Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 239, *cert. denied*, 320 U.S. 751. This attitude makes it the more significant when that court concludes—as it did, notably, in *Blau* v. *Ogsbury*—that the section is *not* applicable.

The court below brushed aside *Blau* v. *Ogsbury* by lumping it with a number of stock reclassification and conversion cases, which it thought to embody "inconsistent results" and not to be "especially helpful" because of their "involving problems peculiar to their own types of transactions" (pages 26-27). Since that case is precisely in point except for the formula element in the contract here, and since Judge Clark's opinion is quite short, the entire opinion is attached hereto as Appendix C, *infra* page 35.

The Second Circuit is highly experienced with litigation under §16(b), most of which originated until recent years in the Southern District of New York. By contrast, neither the First Circuit nor the District Court for Massachusetts has ever before decided a case under that unique and rather peculiar section. We respectfully suggest that the cases cited by the lower court are *not* internally inconsistent; that the only inconsistency is between those cases on the one hand and the decision below on the other; and that the error below perhaps lay not so much in a rejection of the general analysis developed in the earlier cases, principally in the Second Circuit, as in a failure to come to grips with it.

The underlying principle which has gradually emerged, in a search for a construction "in light of the statutory purpose" (cf. *SEC* v. *Ralston Purina Co.*, 346 U.S. 119,

124-25), is that "the transaction is a 'purchase' if in any way it lends itself to the accomplishment of what the statute is designed to prevent." *Blau* v. *Lehman*, 286 F.2d 786, 792 (2d Cir.), *aff'd*, 368 U.S. 403. That is to say, the courts quite properly have paid no attention to whether the director *did in fact have or use* inside information; but, until the present case, they *have* considered whether the circumstances of the particular case were such that, *assuming* the possession or use of inside information, the director *could have* obtained an advantage over the public generally which did not already exist.

This test has been consistently applied not only in determining the date of "purchase,"[1] but also in a series of factually disparate cases involving corporate reclassifications,[2] stock options,[3] arbitrage,[4] and conversions from one class of security to another. The conversion cases afford a particularly good illustration of the "possibility of abuse" test. Thus, in *Park & Tilford, Inc.* v. *Schulte*, 160 F.2d 984 (2d Cir.), *cert. denied*, 332 U.S. 761, a voluntary conversion of preferred shares into common was held to involve a "purchase" of common, whereas in *Ferraiolo* v. *Newman*, 259 F.2d 342, 346 (6th Cir.), *cert. denied*, 359 U.S. 927, the court (through Stewart, C. J.) reached the opposite result because an *involuntary* conversion, forced by a call of the preferred over which the director had no control, was not a transaction "that could have lent itself to the practices which Section 16(b) was enacted to prevent." The lower court's very reference to these two cases as reaching "inconsistent results" (page 26) demonstrates

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[1] See especially *Blau* v. *Ogsbury*, *supra*; *Stella* v. *Graham-Paige Motors Corp.*, *supra*.

[2] *Roberts* v. *Eaton*, 212 F.2d 82, 85-86 (2d Cir.), *cert. denied*, 348 U.S. 827.

[3] *Shaw* v. *Dreyfus*, 172 F.2d 140, 142 (2d Cir.), *cert. denied*, 337 U.S. 907.

[4] *Falco* v. *Donner Foundation, Inc.*, 208 F.2d 600, 604 (2d Cir.).

its being out of tune with the "possibility of abuse" test consistently applied in all the other cases involving "purchases" or alleged "purchases" made otherwise than for cash in the open market.[5]

Application of the "potentiality of abuse" approach to the undisputed facts in the case at Bar demonstrates the irrelevance of the formula element in the contract to distinguish the *Ogsbury* and *Stella* test in terms of the date when the director "incurred an irrevocable liability to take and pay for the stock."[6]

In the first place, with no power in the petitioners to accelerate under the circumstances, there was no conceivable opportunity for them to use inside information in

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[5] For a later conversion case which viewed the two cited cases to be entirely consistent, because "it was the involuntary nature of the conversion in *Ferraiolo* that was a determinative factor in that case," see *Heli-Coil Corp.* v. *Webster*, 222 F. Supp. 831, 834-35 (D. N. J.): "From these and other cases, the following test can be said to emerge for determining whether a particular conversion transaction constitutes a 'purchase' or 'sale': was the conversion the type of transaction that would possibly have lent itself to the short-term speculation that section 16(b) seeks to prohibit? * * * Of course, where the circumstances indicate that a conversion could not in any way have been motivated by a desire to engage in such speculation, the purpose of section 16(b) would not be served by calling the transaction a 'purchase' or 'sale' within the meaning of its language." The *Park & Tilford* case was followed still later in *B. T. Babbitt, Inc.* v. *Lachner*, 332 F.2d 255, 258 (2d Cir.), where the converted preferred was not even callable until ten months after the altogether voluntary conversion.

[6] The District Court here (R. 40-41) made something of the following language in the penultimate paragraph of the *Ogsbury* opinion, after the court had laid down the "irrevocable liability" test: "It matters not to the speculator who has title or possession or who can vote the stock or receive dividends. What he needs is firm assurance that a fixed quantity can be acquired or disposed of at a fixed price; and his commitments are on that basis." 210 F.2d at 427. But there is no indication that the court intended to limit the opinion to fixed quantity as distinct from formula purchases. The case before the court simply happened to involve a fixed quantity purchase. Nevertheless, for one reason or another—notably the time it often takes to get a tax ruling from the Internal Revenue Service—formula purchases as in the case at Bar are well known in the world of business and finance.

fixing the *closing date*, when the actual exchange of share certificates would be effected.[7] Indeed, if the physical acquisition of share certificates pursuant to a mutually binding contract made several years previously were to constitute a "purchase" notwithstanding the director's utter lack of choice with respect to the selection of the closing date, a director might be ensnared by §16(b) as the result of an altogether legitimate sale effected on the market at any time during the interval between the execution of the contract and its closing, which in this case was more than three years. Suppose that in late 1960, more than a year after the execution and more than a year before the closing if the closing were not accelerated by Varian, one of the petitioners, deciding that it was imprudent to keep all his eggs in one basket, had sold a few thousand shares of Varian on the Stock Exchange. And suppose that Varian had then accelerated the closing to a date less than six months after the market sales. If the Varian market had gone down between the date of the market sale and the accelerated closing date, the petitioner would have been liable, pursuant to the holding below, for the difference multiplied by the number of shares sold. For §16(b) applies equally to any profit realized "from any purchase

[7] It was in making this point that we argued below that, since the petitioners were only two out of a total board of fifteen directors (R. 12) and they and their immediate families owned (directly and indirectly) not more than seven percent of the outstanding Varian shares (R. 15), it would be "fanciful" to suggest that it was the petitioners who dictated the actual closing date—an argument which the court below said "disregards their [the petitioners'] own quite proper concession that the act purports only to be a 'crude rule of thumb'" (page 29). The "crude rule of thumb" characterization indicates merely that the plaintiff need not prove an actual use of inside information in the particular case as long as he shows a purchase and sale within a period of less than six months. When the very question at issue is whether there *was* a "purchase" within the statutory period, our pointing to the petitioners' lack of control over the closing date is thoroughly consistent with the "potentiality of abuse" rationale.

and sale, *or any sale and purchase*, * * * within any period of less than six months." This hypothetical (though by no means farfetched) possibility demonstrates, perhaps as much as anything, that the effect of the holding below is to stretch the six-month period in §16(b) to a period of *forty* months in the case at Bar.

In the second place, the petitioners *might* have benefited from a short-term use of inside information if they had sold on the market within less than six months after the date of *execution* of the contract in 1959. If they had learned as new Varian directors that the shares were overpriced in the market, and that something like an undisclosed antitrust or patent infringement claim against Varian gave it a bleak prospect for the indefinite future, they could safely have sold as much as $2,000,000 worth of stock at current prices without worrying about *how much* lower the market would be on the date of closing than on the date of their market sales; for the formula adjustment to reflect the lower market on the closing date would mean that they would have *some* shares left over after deducting the number of shares sold on the market, and they would thus have had a ***short-term*** profit, ***based on inside information***, from a "purchase" (on the date of execution of the contract) and a market sale within less than six months.[8] *This*, most assuredly, is the case which

[8] This hypothetical (but, again, by no means farfetched) possibility demonstrates the error in saying, as the lower court did, that the formula element "made speculation against the contract not only risky but * * * virtually impossible," however true it may be that it sheltered the petitioners "from the possible advantages or disadvantages of a fluctuating market" (page 28). In any event, whatever the petitioners' opportunity for short-term trading on inside information in relation to the date of *execution* of the contract, the more critical point is that they had *no opportunity* whatever for such trading in relation to a *closing* date which was entirely beyond their control. This in itself should be conclusive in construing §16(b). *Cessante ratione cessat ipsa lex.*

Indeed, the lower court conceded that our contention that lack of

should be covered by §16(b)—not the case at Bar. Thus, the decision below not only recaptures a profit which could not possibly have resulted from the use of information obtained on the closing date, whose choice was entirely beyond the petitioners' control; it also precludes recapture of a profit which might very well have resulted from the use of inside information if there had been a sale within six months after the date in 1959 when both parties had become firmly committed. For a plaintiff under §16(b) cannot have it both ways, selecting whichever date (execution or closing) would result in a recovery. There cannot be "two 'purchases' where in fact but one exists." *Blau* v. *Ogsbury*, *supra*, 210 F.2d at 427.

In the third place, the possibility that the directors may have had inside information in determining when to *sell their shares in the market*, some four months after the closing date in 1962, is irrelevant. For they had bought *in the market* in 1959, there could be no recovery under §16(b) regardless of how much inside information they might have had at the time of sale more than three years later. This is not "circular reasoning," as the court below put it (page 29). On the contrary, we respectfully suggest that it is the court's reference to the possibility of the use of inside information in determining when to sell which is question-begging when the very point at issue is whether the "purchase" occurred in 1962 or back in 1959. Under the lower court's approach the plaintiff would *always* win.

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control over the closing date diminished the opportunity to make insider profits was "possibly persuasive in one sense" (page 29). The court's only answer was that this overlooked the fact that the petitioners were directors at all material times, and that our argument that it was "fanciful" to suggest that they could control the board's selection of the closing date disregarded our concession that §16(b) was only a "crude rule of thumb." But we have already shown the fallacy of that answer in note 7 *supra*. Therefore, the lower court's characterization of our argument directed to the lack of control over the closing date as "possibly persuasive" remains unanswered.

even in a case like *Blau* v. *Ogsbury* involving a delayed closing date at a *fixed* price; for, by hypothesis, there would always be a period of less than six months between the closing date and the subsequent (or prior) market sale, and the court might just as readily have selected the closing date in *Ogsbury* on the ground that the defendant there might have used inside information *in determining to sell* within less than six months before he took down his shares pursuant to a firm commitment made (as in this case) some three years earlier. (That case happened to involve a sale-purchase rather than a purchase-sale sequence, but, as we have seen, §16(b) applies equally in both instances.)

In the fourth place, we suggest that the question is further begged, and the "irrevocable liability" test obfuscated, by the court's statement that "it is important that we consider the probability of bringing the insider to task for his violation of the statute" (page 27). On that approach, presumably, the plaintiff would likewise have won if the case had happened to involve a sale within less than six months after the execution rather than the closing date. Surely the fortuity of which case happens to get litigated first—the case of a sale within a few months after the closing date or the case of a sale within a few months after the execution date—should hardly determine which of the two cases is covered by the statute. Yet that seems to be the implication of the court's approach.

All this establishes that the First and Second Circuits are in basic conflict on an important and recurring question of construction of §16(b). Although the court below purported to determine which of the two dates "would be more likely to lend itself to the abuses the statute was designed to protect against" (page 27), the result is at odds with an otherwise consistently applied rationale which was gradually producing a reasonable degree of predict-

ability in the various situations raising a question as to the existence or timing of a "purchase."[9]

Second: The decision below is in conflict also with the consistent administrative construction in closely analogous situations:

(1) The SEC early published an opinion of its General Counsel to the effect that beneficial ownership for purposes of the reporting requirement in §16(a) is acquired or divested when the insider "takes a firm commitment" for the purchase or sale of securities. Securities Exchange Act Release 116 (1935), 11 Fed. Reg. 10968, §241.116, *infra* App. D, page 38, quoted in *Stella* v. *Graham-Paige Motors Corp.*, 232 F.2d 299, 301, n. 2 (2d Cir.), *cert. denied*, 352 U. S. 831.

(2) In the cognate situation of determining when a person becomes an owner for purposes of the Commission's short-selling rules under §10(a) of the same statute, 48 Stat. 891, 15 U. S. C. §78j(a), which in general prohibit short sales on a falling market, the similar position has been taken administratively in cases of warrants, options, conversions and exchanges of securities that a person becomes the owner of the security called for as soon as

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[9] The court below was perhaps influenced as much as anything by the two-year statute of limitations in §16(b), which contrasts with the lapse of more than three years between the execution and closing dates. pages 27, 28. But this presents only a problem of mechanics. Surely the simple answer is that a timely action, brought within two years after a sale which followed shortly after a "purchase" consisting of the execution of a firm contract to buy at a formula price, could be stayed until the closing date, when the amount of any profit would be established by the precise formula in the contract. Surely, too, it is better to suffer whatever slight clumsiness this might entail than to establish a precedent which would not only (1) recapture the profit from what we insist was a sale three years after the purchase but also (2) make it *impossible* to recapture what might turn out to be a substantial profit resulting from an abuse of inside information in short-term trading within less than six months after the director undertakes an irrevocable liability.

he notifies the issuer of his desire to exercise his warrants or convert or exchange his old securities. Securities Exchange Act Release 1571 (1938), 11 Fed. Reg. 10969, §241.1571, *infra* App. D, page 38.

(3) Whereas §10(a) prohibits short sales generally only when made in contravention of such rules as the SEC may adopt, and whereas §16(b) makes nothing unlawful in the criminal sense, §16(c), 48 Stat. 897, U. S. C. §78p(c), does make it unlawful in the criminal sense (and without regard to any implementing rules) for a director (or any of the other "insiders" covered by §16 generally) to sell short under any circumstances. Presumably the two published opinions with respect to §§16(a) and 10(a) apply equally to §16(c). That is to say, those opinions would have given the petitioners and their counsel every reason to believe that (subject, of course, to the rules under §10(a), which are of universal application) they could legally sell *some* shares short after undertaking their firm commitment in 1959, even if they had not already owned a substantial quantity of Varian shares acquired in the early exchange for the first 80 percent of the Bomac stock. Nothing in the language or logic of either opinion is limited to fixed price as distinct from specific formula arrangements.

A consistent administrative construction by the expert agency which must strive to make a logical and workable whole out of an inevitably complex statute is, of course, entitled to "great weight." *United States* v. *American Trucking Assns., Inc.*, 310 U. S. 534, 549; *FTC* v. *Mandel Bros., Inc.*, 359 U. S. 385, 391; *Charles Hughes & Co., Inc.* v. *SEC*, 139 F.2d 434, 437 (2d Cir.), *cert. denied*, 321 U. S. 786. Moreover, we suggest that in an area in which precise judicial precedent is at best sparse, and in which civil liability (not to mention the possibility of criminal sanctions) may be created with such automaticity, persons who

may be subject to the impact of the statute, as well as their legal advisers, are entitled to rely upon published opinions of the administrative agency and its officers for guidance. What other function do such opinions serve?

All this was argued to the court below but finds no echo in its opinion.

Third: The court below has erroneously decided an important question of federal law which should be settled by this Court. The importance and the harmful potential of a disharmonious decision on a recurring question under §16(b) are emphasized by the consideration that that section, together with the courts' implication of private actions under the SEC's proxy rules[10] and its Rule 10b-5, 17 C. F. R. §240.10b-5, which has to do with fraud "in connection with the purchase or sale" of any security,[11] is creating what Judge Friendly and others have called a "federal common law of corporations" in the important area of management-securityholder relationships.[12]

The cases in all three contexts have been proliferating at a continually accelerated pace. With respect to §16(b) alone, at least twenty of the eighty-odd cases to result in some sort of reported opinion have been decided in the last thirty months, which is to say, the last two and one-

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[10] *J. I. Case Co.* v. *Borak*, 377 U.S. 426; for the history and implications of this development, see 2 Loss, *Securities Regulation* (2d ed. 1961, Supp. 1962) 931-1019.

[11] See 3 *id.* 1445-74, 1763-97.

[12] See Judge Friendly's perceptive Cardozo Lecture, *In Praise of Erie —and of the New Federal Common Law*, 19 Record of N. Y. C. B. A. 1, especially at 23 (1964). "It can be said fairly that the Exchange Act * * * constitutes far reaching federal substantive corporation law." *McClure* v. *Borne Chemical Co., Inc.*, 292 F.2d 824, 834 (3rd Cir.). See also Cary (then SEC Chairman), Book Rev., 75 Harv. L. Rev. 857, 858 (1962); *Cady, Roberts & Co.*, 40 SEC 907, 910, n. 10 (1961); *Franchard Corp.*, SEC Sec. Act Rel. 4710 at 20, n. 36, CCH Fed. Sec. L. Rep. ¶77,113 at 82,046-47, n. 36 (1964); 1 Loss, *op. cit. supra*, at vii.

half of the thirty years since the enactment of the section have produced almost one-quarter of all the reported opinions.[13] Moreover, the President on August 20 signed the Securities Acts Amendments of 1964, Public 88-467, 88th Cong., legislation which, among other things, extends §16 beyond companies with equity securities listed on a stock exchange to all companies in interstate commerce which have $1,000,000 of assets and a class of equity security held by 750 persons (a figure which is to be reduced automatically to 500 after two years). This extends the coverage from something over 2400 listed companies as of June 30, 1963,[14] by adding an estimated 3100 additional companies (3900 when the standard falls to 500 stockholders).[15]

The development of this body of federal corporation law has been a wholesome phenomenon in terms of raising the fiduciary standards of corporate "insiders" and correcting the "grave omission in our corporation law," as Judge Learned Hand put it in one of the early §16(b) cases, consisting of "its indifference to dealings of directors or other corporate officers in the shares of their companies." *Gratz* v. *Claughton*, 187 F.2d 46, 49 (2d Cir.), *cert. denied*, 341 U. S. 920. It might even be said that §16(b), specifically, is in the best tradition of "native American radicalism." But voices have repeatedly urged that Congress should repeal the section or at least smooth the rough diamond's edges. Indeed, whereas the SEC's *Report of Special Study of Securities Markets* (which was ordered by Congress in §19(d) of the Securities Exchange Act, 75 Stat. 465, 15 U. S. C. §78s(d), added in

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[13] These twenty cases are cited in Appendix E, *infra* page 42. The first sixty-odd cases are cited in 2 Loss, *op. cit. supra*, c. 6C.

[14] 29 SEC Ann. Rep. 39 (1963).

[15] *SEC Legislation, 1963*, Hearings before Subcom. of Senate Com. on Banking & Currency on S. 1642, 88th Cong., 1st Sess. (1963) 14-15.

1961, and which led to the passage of the Securities Acts Amendments of 1964) concluded that there was no need for a general and broad exemption from §16(b) to permit dealers to make or "sponsor" over-the-counter markets in securities of companies on whose boards they are represented,[16] the Commission apparently considered it prudent to yield, in the interest of getting the amendments through, to the extent of concurring in a new §16(d) which does broadly exempt from both §16(b) and §16(c) all transactions "by a dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market" over the counter.[17]

Section 16(b) *is* a rough diamond. Cf. *Wolf* v. *Weinstein*, 372 U. S. 633, 643 and n. 11, a case under §249 of Chapter X of the Bankruptcy Act, 52 Stat. 901, 11 U. S. C. §649,

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[16] 3 SEC, *Report of Special Study of Securities Markets*, H. R. Doc. No. 95, 88th Cong., 1st Sess. (1963) 49-51, 54-55, 63-64 (¶5).

[17] 1 *Investor Protection*, Hearings before Subcom. of House Com. on Interstate & Foreign Commerce, 88th Cong., 1st Sess. (1963) 653-54 (¶7), 668; 2 *id.* 1222, 1226. In 1941, when the SEC and a subcommittee of the House undertook a general review of the securities laws, representatives of the securities industry and of corporate management urged the outright repeal of §16(b). See 2 Loss, *op. cit. supra*, at 1088, especially the citations in n. 212. Again, the SEC, in connection with the legislative program which led to the 1964 amendments, resisted a recommendation by its special study group of a statutory reversal of this Court's decision in *Blau* v. *Lehman*, 368 U.S. 403, because it "believed that any amendment to section 16(b) would invite numerous proposals for general revision of this section." 2 *Investor Protection*, *supra*, at 1201. And in a letter of January 30, 1964, Chairman Cary of the SEC, stating that §16 "has aroused strong feelings, and there has been a persistent demand for its revision or repeal," and referring to a series of suggestions by the Committee on Securities Regulation of the Association of the Bar of the City of New York which in combination "would have substantially reduced the scope of section 16(b)," advised the Chairman of the appropriate House subcommittee: "Basically we had no desire to see our vital legislative program impeded in any way by a presumably long drawn out, bitter, and often technical controversy over various aspects of section 16." *Ibid.* For a criticism of some of the §16(b) constructions as needlessly arbitrary, see Painter, *The Evolving Role of Section 16(b)*, 62 Mich. L. Rev. 649 (1964).

where the Court, noting the "common origins and parallel purposes of §249 and §16(b)," characterized the policies underlying §16(b) as requiring "a similarly pervasive and unbending rule against certain forms of insider trading." Moreover, one cannot have a maximum of equity concurrently with the objective, rule-of-thumb approach epitomized in §16(b). Nevertheless, needlessly arbitrary results which are unrelated to the purpose to be served by the section—which, indeed, may be actually hostile to that purpose (as we have seen) in the sense that the judgment below would frustrate recapture of a short-term profit resulting from a sale on inside information obtained shortly after a director takes the meaningful, volitional step of assuming an irrevocable commitment to purchase shares—can only fan the flames of repeal or crippling modification of a provision which has afforded a much needed prophylaxis.

In short, the rapid development of an *Erie*-resistant, legislatively and administratively based "federal neo-common law," which is displacing the state law of corporations in important areas, requires (we respectfully submit) the occasional exercise of this Court's supervisory powers lest, on the one hand, the general development get out of control or, on the other hand, judicial overenthusiasm be allowed to encourage the legislative undoing of much of the reform which thoughtful commentators have strenuously applauded.

At the same time, there is no need to fear a deluge of §16(b) cases in this Court. It goes without saying that this is not of itself a reason for granting the petition. But the very fact that this petition if granted will bring only the second of eighty-odd reported cases under §16(b) to the Court is a consideration to be weighed in the balance.

Fourth: The conflict between the result below and the line of cases elsewhere, principally in the Second Circuit,

is exacerbated by the forum-shopping possibilities inherent in the broad choice of venue afforded by §27 of the Securities Exchange Act, 48 Stat. 902, 15 U.S.C. §78aa. That section gives the plaintiff a choice between "the district wherein the defendant is found or is an inhabitant or transacts business" and "the district wherein any act or transaction constituting the violation occurred," with nationwide service of process in either event. And it has been held that, for purposes of the venue provision, any conduct actionable under §16(b) "is as much a 'violation' of law as though it were attended by the sanction of imprisonment." *Gratz* v. *Claughton*, 187 F.2d 46, 49 (2d Cir.), *cert. denied*, 341 U.S. 920.

With the scope of §16(b) limited until the recently enacted Securities Acts Amendments of 1964 to securities listed on a stock exchange, and with the great bulk of all the exchange business effected on the two exchanges in New York, plaintiffs in the past have favored the Southern District of New York—partly, it must be presumed, because of the "tough" approach shown by the Second Circuit to §16(b) generally. This forum-shopping *toward* the Second Circuit is apparent not only from the number of §16(b) cases in that court and the Southern District of New York against persons resident elsewhere, but also from several opinions in which the Southern District of New York has ruled on motions for transfer under the modification of the *forum non conveniens* doctrine in §1404(a) of the Judicial Code, 28 U. S. C. §1404(a).[18] Now, conversely, plaintiffs will be encouraged, in "de-

[18] *Blau* v. *Lamb*, 20 F. R. D. 411, 415 (S. D. N. Y.) (removal to Ohio *refused*); *Polaroid Corp.* v. *Casselman*, 213 F. Supp. 379 (S. D. N. Y.) (removal to Massachusetts *granted*); *Sher* v. *Johnston*, 216 F. Supp. 123 (S. D. N. Y.) (removal to Virginia *granted*); *Franklin* v. *Blaylock*, 218 F. Supp. 261 (S. D. N. Y.), *mandamus denied* sub. nom. *Blaylock* v. *McLean*, 319 F.2d 533 (2d Cir.), Lombard C.J., dissenting (removal to Texas *denied*).

layed purchase" and analogous cases of various sorts, to shop for a forum *away from* the Second Circuit, whenever possible, in the hope that other circuits will follow the approach of the First Circuit rather than the Second.

This does not augur well for the uniform construction which is particularly essential in a provision like §16(b) precisely because of its objective and automatic character.

Fifth: So far we have not referred to the second question, involving the "debt" exemption in §16(b). Were that the only question, the case for certiorari would obviously be weaker. At the same time, this important exemption badly needs elucidation. No light is thrown by the legislative history. The few decided cases are of little more help.[19] And we hope to be able to demonstrate, if the petition is granted, that the construction of the "debt" exemption below does clash in important respects with *Rheem Mfg. Co.* v. *Rheem*, 295 F.2d 473 (9th Cir.), the case in which the exemption has received its only reasonably thorough consideration thus far.

If we ultimately prevail on the first question, the second need not be reached. But we respectfully urge the Court not to limit the scope of the writ to the first question if the petition is granted. For it is our position that the decision below illogically drops the petitioners between two stools in that, if their irrevocable liability in 1959 did *not* constitute a "purchase" at that time, it certainly created a fixed obligation on the part of Varian to deliver a readily ascertainable number of dollars' worth of stock not later than a date certain. In that sense the two questions are related and they should not be separated.

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[19] *Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 239 (2d Cir.), *cert. denied*, 320 U.S. 751; *Park & Tilford, Inc.* v. *Schulte*, 160 F.2d 984, 987 (2d Cir.), *cert. denied*, 332 U.S. 761; *Truncale* v. *Blumberg*, 80 F. Supp. 387, 392 (S. D. N. Y.); *Heli-Coil Corp.* v. *Webster*, 222 F. Supp. 831, 835-36 (D. N. J.).

Many courts have followed the 1842 definition of "debt" by the Massachusetts Supreme Judicial Court in *Gray* v. *Bennett*, 3 Metc. 522, 526:

> The word "debt" is of large import, including not only debts of record, or judgments, and debts by specialty, but also obligations arising under simple contract, to a very wide extent; and in its popular sense includes all that is due to a man under any form of obligation or promise.

Moreover, in the absence of a legislative definition there is no reason in statutory context not to give "debt" the meaning it has "in common understanding and in the common use of language." Cf. *Helvering* v. *Hutchings*, 312 U. S. 393, 396. Indeed, the borrowing of stock rather than cash is an everyday occurrence on Wall Street in effecting delivery pursuant to short sales. See *Provost* v. *United States*, 269 U. S. 443.

In sum, on the assumption *arguendo* that there was no "purchase" until the closing date, the petitioners' acquisition of the shares satisfied all three conditions of the exemption: (1) A fixed obligation is no less a debt because it is payable in stock. (2) The debt here *was* previously contracted.[20] And (3) Varian has filed no counter-

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[20] The purely descriptive statement in *Rheem*, 295 F.2d at 476, "Here there was an obligation to pay a fixed sum * * * existing prior to and apart from the settlement of the obligation by the transfer of stock," became for the court below a mandate that the "debt previously contracted" *must* be "an obligation to pay a fixed sum * * * existing prior to and apart from the settlement of the obligation by the transfer of stock" (page 30). Moreover, in *Heli-Coil Corp.* v. *Webster*, 222 F. Supp. 831, 836 (D. N. J.), relied upon by the court below, the defendant sought to apply the debt exemption to the acquisition of common stock on conversion of debentures, and the court's reasoning was that the conversion did not involve "good faith settlements of independent and matured obligations" because the debentures "were not to mature until November 1973, and were subject to a number of

affidavits to challenge the facts in the Booth affidavit (R. 7-38) which establish the petitioners' "good faith."[21]

Conclusion

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

Louis Loss
Langdell Hall
Cambridge 38, Mass.

C. Henry Glovsky
173 Cabot Street
Beverly, Mass.
Counsel for Petitioners

October 1964

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conditions which negative the generally accepted concept of a 'matured debt', such as a right of redemption, convertibility into common stock, adjustment of conversion price to protect against dilution, and so forth."

[21] The lower court's observation that application of the debt exemption here would "open the door to widespread evasion of the act" (page 30) not only ignores the defendant's burden of showing "good faith." It also overlooks the holding in *Rheem*—a holding which is implicit in the very concept of "good faith"—that " 'the crude rule of thumb' and objective measure of proof which form the bases of the principal clause of §16(b) have been expressly abandoned in this exemption," which "requires us to look to subjective intent." 295 F.2d at 476, 477.

Appendix A

OPINION AND JUDGMENT OF COURT OF APPEALS

United States Court of Appeals
For the First Circuit

No. 6277.

HAROLD C. BOOTH ET AL.,
DEFENDANTS, APPELLANTS,
v.
VARIAN ASSOCIATES,
PLAINTIFF, APPELLEE.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS
[224 F. Supp. 225]

Before WOODBURY, *Chief Judge*, and HARTIGAN and ALDRICH, *Circuit Judges*.

Louis Loss, with whom *C. Henry Glovsky* and *Glovsky & Glovsky* were on brief, for appellants.
Frank W. Crocker, with whom *Edward A. Benjamin* and *Ropes & Gray* were on brief, for appellee.

OPINION OF THE COURT.

July 15, 1964.

HARTIGAN, *Circuit Judge*. Plaintiff-appellee, Varian Associates, a California corporation, brought an action in the United States District Court for the District of Massachusetts under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p (b), to recover alleged "inside profits" made by defendants-appellants, Harold C. Booth and Henry J. McCarthy, both of Massachusetts, on the sale of certain shares of Varian stock. From the granting of

the appellee's motion for summary judgment, entered December 12, 1963, appellants appeal.

The facts are not in dispute. In January, 1959 Varian acquired 80% of the outstanding shares of Bomac Laboratories, Inc., a Massachusetts corporation. Most of these shares were acquired from appellants, who remained owners of the remaining 20% of the Bomac stock. Shortly thereafter appellants became members of the board of directors of Varian.

On January 14, 1959 Varian and appellants entered into a contract entitled "Agreement For Exchange of Stock," amended on February 26, 1959, under which appellants agreed to sell to Varian their remaining shares of Bomac stock in return for that number of shares of Varian stock which, on the basis of the market quotations of the day before the closing, would equal in value $2,000,000 plus 20 per cent of the amount by which the retained earnings of Bomac at the end of the month preceding the closing exceeded the retained earnings on December 31, 1958. The closing date was to be July 2, 1962, subject to acceleration by Varian, or in certain limited circumstances by appellants. The closing was in fact accelerated by three days by Varian and the actual exchange of shares took place on June 29, 1962. Since late in 1959 appellee's shares have been listed on the New York Stock Exchange.

Within less than six months after June 29, 1962 appellants sold some of their shares of Varian on the New York Stock Exchange at a profit over the June 29 market of $42,895 for appellant Booth and $12,309 for appellant McCarthy. These profits are recoverable under § 16 only if the sales of the stock took place within six months of the purchases.

The objectives sought to be accomplished by Congress in adopting Section 16(b) are clear from the statute which, in pertinent part, reads as follows:

> "(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, ..."

It was recognized that those covered by the statute might have information not accessible to a shareholder, actual or prospective, and would thus possess an unfair advantage in market dealings. *Gratz* v. *Claughton*, 187 F.2d 46 (2d Cir.), cert. denied, 341 U.S. 920 (1951). The statute is remedial rather than penal, *Adler* v. *Klawans*, 267 F.2d 840 (2d Cir. 1959), and includes all profits realized by those assumed by the statute to have access to inside information whether or not an intention to profit from an unfair use of information can be shown. *Smolowe* v. *Delendo Corporation*, 136 F.2d 231 (2d Cir.), cert. denied, 320 U.S. 751 (1943). If, as directors of Varian, appellants negotiated a sale of Varian stock within six months of the date of purchase, they are liable to appellee for the profit resulting from such sale.

Section 3(a)(13) of the Act, 15 U.S.C. § 78c(a), states that "unless the context otherwise requires" the term "purchase" includes "any contract to buy, purchase or otherwise acquire." Appellants contend that the "purchase" of the Varian shares occurred at the time in 1959 when appellants entered into a mutually binding agreement to exchange their Bomac shares for those of appellee, although the number of Varian shares and their price on the date of exchange was then indeterminable due to the formula aspect of the agreement. Appellee contends that

the "purchase" did not take place until June of 1962 when appellants received a specific number of shares at a specific price.

To further their respective arguments and due to a dearth of cases involving a contract containing terms similar to those here in issue, both sides have relied to a great extent upon cases concerned with the application of Section 16(b) to options, warrants, conversions and like transactions. *E.g., Blau* v. *Ogsbury*, 210 F.2d 426 (2d Cir. 1954) (options); *Roberts* v. *Eaton*, 212 F.2d 82 (2d Cir.), cert. denied, 348 U.S. 827 (1954) (re-classification); *Park & Tilford* v. *Schulte*, 160 F.2d 984 (2d Cir.), cert. denied, 332 U.S. 761 (1947) (conversion). While these cases contain language applicable to the present fact situation, it must be noted that they have presented special problems as to time and price of purchase and sale not easily fitted into the statutory framework nor directly relevant to the problem immediately before us.[1] Options, conversions and similar devices have lent themselves quite readily to the abuses uncovered in the Congressional investigation antedating the Act, and in order to give maximum support to the statute courts have attempted to include these transactions by characterizing them as purchases or sales. This has led to inconsistent results in the decisions, compare *Park & Tilford* v. *Schulte*, *supra*, with *Ferraiolo* v. *Newman*, 259 F.2d 342 (6th Cir. 1958), cert. denied, 359 U.S. 927 (1959), and conflicting views among the commentators. Compare Cook and Feldman, Insider Trading Under the Securities Exchange Act, 66 Harv. L. Rev. 612 (1953), with Hardee, Stock Options and the "Insider Trading" provisions of the Securities Ex-

[1] See Comment, Put and Call Options Under Section 16 of the Securities Exchange Act, 69 Yale L. J. 868 (1960).

The option cases have raised the question of drawing a line at where the option, involving as it does a right to purchase *at a specific price*, has become in fact a "purchase."

change Act, 65 Harv. L. Rev. 997 (1952). The practice of the courts in option cases of using one "purchase" date for the purpose of deciding whether profits are "short swing" and another "purchase" date for the purpose of measuring those profits led to the Commission's formulation of a rule mitigating the loss to the insider option holder found to have violated the statute. 17 C.F.R. §240.16b-6. See *Blau* v. *Hodgkinson*, 100 F. Supp. 361 (S.D. N.Y. 1951). In sum, we do not believe cases of the classes referred to, involving problems peculiar to their own types of transactions, are especially helpful in deciding the case before us.

As there are no cases which we can turn to for substantial precedent, it is proper that we attempt to resolve the question involved in a manner that is practical and logical and will be most consonant with the statutory purpose. The question thus becomes one of balancing the respective advantages and disadvantages of each contended for "purchase" date and determining which one, if held to be the date of purchase, would be more likely to lend itself to the abuses the statute was designed to protect against. *Adler* v. *Klawans, supra.* See *S.E.C.* v. *Ralston Purina Co.*, 346 U.S. 119, 125 (1953). In addition, since we are dealing with a remedial measure, it is important that we consider the probability of bringing the insider to task for his violation of the statute. If one date lends itself to the possibility of abuse as much as the other but, because of the statute of limitations attached to Section 16(b), it would be difficult, if not impossible, to gain recovery against an insider who "purchased" on one of the contended for dates, then practical experience dictates that the purchase date within the recovery period should be selected as the one the statute was designed to include.

Although the agreement of January 1959 firmly committed both parties to an eventual exchange of shares, it

by no means constituted a completed arrangement. Not only did it leave the purchase price unfixed, it provided that the price should be fixed at the closing market quotation on the day prior to the closing, nearly three and one-half years later, thus making the purchase under the contract as much as possible *like a market purchase at the time of the closing*. Besides sheltering appellants from the possible advantages or disadvantages of a fluctuating market, this would appear to have made speculation against the contract not only risky but, as appellee contends, virtually impossible.

To counter this observation and using January 1959 as the purchase date, appellants construct a hypothetical situation illustrating how it would have been possible for them to have violated the statute by means of a sale within six months of the January 1959 date. The illustration reflects more than the usual speculative risk, relying as it does on the presumed knowledge of the insiders in 1959 that upon receipt of their contracted for shares in 1962, the market will be low enough for them to make a profit on their 1959 sale which had been made in a rising market. Appellants, of course, recognize that a profit from the 1959 sale, if any, could not be calculated until the stock was acquired by them in 1962 and its purchase price fixed. The basis of liability under § 16(b) being that the insider has, in fact, made a profit, it is likely that the two year statute of limitations would have expired before this essential fact was known and no recovery would have been possible.

On the other hand, the assumption of June 1962 as the date of "purchase" would be more consonant with the statute. For one thing, only on that date did the insiders know the amount of how much stock they were to receive and the price of each share, generally critical information for those whose potential profit from speculation is based upon an advantageous sale. Second, from an investment

standpoint, appellants had no position in Varian during the three and one-half years interval between January 1959 and June 1962. Their investment position did not arise until the exchange ratio was fixed, no earlier than the close of the stock market on June 28, 1962. When they sold on the market later in 1962, their profits, in point of fact, were attributable to only *a short term investment* in appellee's stock. Third, a "purchase" made on June 28, 1962, followed by a sale within six months will be easily susceptible to enforcement.

Appellants concede the *possibility* of their having had inside information in determining when to sell their shares in the market in 1962, but contend that this is irrelevant and that there could be no cause of action therefor because the purchase occurred in 1959. At best this is circular reasoning since the date of the purchase is the point at issue.

The fact that Varian retained the right to accelerate the date of the final transaction does not help appellants. In one way it makes even more imprecise their concept that the purchase occurred in January 1959, for it rendered uncertain not only the number of shares that were allegedly then purchased, but the date of acquisition. Appellants' contention that their lack of control over the date diminished their opportunity to make insider profits, while possibly persuasive in one sense, overlooks the fact that they were at all material times insiders so far as Varian was concerned because of having two directorships. Section 16(a). Their argument that this was only "fanciful" control disregards their own quite proper concession that the act purports only to be a "crude rule of thumb."

An additional argument advanced by appellants is that, in any event, the transaction fell within the exemption provided by Section 16(b) of the Act on the ground that the Varian shares were "acquired in good faith in connection

with a debt previously contracted." They contend that if the "purchase" did not take place in 1959, then at least there existed "a fixed and enforcible obligation to deliver a readily ascertainable number of dollars' worth of stock" and, therefore, the acquisition of these shares by appellants in 1962 was in connection with a "debt previously contracted" within the meaning of the statute. The district court gave scant credence to this argument and rightly so, for, as the court stated, to adopt appellants' point of view would "open the door to widespread evasion of the act, since any acquisition of stock could take the form of a contract in which the seller would owe a debt, that is, would have a firm obligation to deliver the stock at some future date, and the buyer would also owe a debt, that is, would have a corresponding obligation to pay for the stock at a future date in money or other property." 224 F. Supp. at 227.

Under the agreement it was clearly necessary for appellants to accept Varian stock in payment for the delivering up of their remaining interest in Bomac. This was not the situation present in *Smolowe* v. *Delendo Corporation*, *supra*, or in *Rheem Manufacturing Company* v. *Rheem*, 295 F.2d 473 (9th Cir. 1961) where the exemption was allowed because the stock in issue was delivered in payment of "independent and matured obligations." *Heli-Coil Corporation* v. *Webster*, 222 F. Supp. 831, 836 (D.N.J. 1963). As the court recognized in *Rheem Manufacturing*, *supra* at 476, the existence of a "debt previously contracted" is determined by "an obligation to pay a fixed sum certainly and at all events existing prior to and apart from the settlement of the obligation by the transfer of stock. . . ."

Judgment will be entered affirming the judgment of the district court.

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 6277.

HAROLD C. BOOTH ET AL.,
DEFENDANTS, APPELLANTS,

v.

VARIAN ASSOCIATES,
PLAINTIFF, APPELLEE.

JUDGMENT

July 15, 1964.

This cause came on to be heard on appeal from the United States District Court for the District of Massachusetts, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The judgment of the District Court is affirmed.

By the Court:

(s) ROGER A. STINCHFIELD
Clerk.

[cc: Messrs. Loss and Crocker.]

Appendix B

PERTINENT PROVISIONS OF SECURITIES EXCHANGE ACT OF 1934, 48 Stat. 881, 15 U.S.C. §78a *et seq.*

SECTION 3. (a) When used in this title, unless the context otherwise requires—

* * *

(13) The terms "buy" and "purchase" each include any contract to buy, purchase, or otherwise acquire.

* * *

SECTION 16. (a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuers of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security

was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

(c) It shall be unlawful for any such beneficial owner, director, or officer, directly or indirectly, to sell any equity security of such issuer (other than an exempted security), if the person selling the security or his principal (1) does not own the security sold, or (2) if owning the security, does not deliver it against such sale within twenty days thereafter, or does not within five days after such sale deposit it in the mails or other usual channels of transportation; but no person shall be deemed to have violated this subsection if he proves that notwithstanding the exercise of good faith he was unable to make such delivery or deposit within such time, or that to do so would cause undue inconvenience or expense.

* * *

SECTION 27. The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or in an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

Appendix C

BLAU *v.* OGSBURY ET AL.

210 F.2d 426 (2d Cir.)

Decided Feb. 10, 1954.

Before CHASE, *Chief Judge*, CLARK, *Circuit Judge*, and GIBSON, *District Judge*.

CLARK, Circuit Judge.

This appeal arises from a defendants' judgment in an action by Isadore Blau, stockholder, to recover alleged insider short-swing profits under § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78p(b), realized from purchase and sale of securities of the nominal defendant, Fairchild Camera and Instrument Corp., by James S. Ogsbury, deceased. Ogsbury at all times material was an officer and director of Fairchild. Under an agreement dated August 19, 1941, lasting until December 31, 1945, Ogsbury was made chief executive of the company, and as part of his compensation was given an unassignable option to purchase 10,000 shares of the company's stock at $4.50 per share, valid until the terminal date of the agreement or one year from the date of his death, whichever first occurred. Originally the option was to be exercised by mailing of notice to the company, the date of mailing to be the effective date for the transfer of title; but on August 7, 1945, the parties amended the agreement to provide for postponement of payment at Ogsbury's election, until termination of employment or six months from his death. Under the new provisions, title and stockholder rights remained in the company pending payment, though the agreement clearly specified that mailing of the notice of election would obligate Ogsbury for the purchase price.

On December 29, 1945, Ogsbury mailed to Fairchild notice of his election to purchase 10,000 shares under the option. Thereafter he postponed payment until on December 8, 1948, he tendered $45,000 and on December 13, 1948, duly received the stock. Prior to this final transaction, on July 19 and 20, 1948, he had sold 600 shares of identical stock for an average price of $27.875 per share. On these facts Blau brought action against Ogsbury's executrix and the corporation; and in the action he moved for summary judgment claiming a profit of $11,000 for the corporation's benefit on the purchase and sale of 600 shares. In a reasoned opinion Judge Bondy denied this motion and instead granted the defendants' motion for summary judgment.

Plaintiff contends that the 1948 payment for the stock was a "purchase" within § 16(b); and since it followed the July sale by less than six months, he finds a violation. We do not agree. Instead we agree with Judge Bondy that the "purchase" was consummated in 1945 when Ogsbury mailed his notice of election and thereby incurred an irrevocable liability to take and pay for the stock. Thereafter for all speculative purposes he owned the stock.

Section 3(a)(13) of the Act, 15 U.S.C.A. § 78c(a)(13), provides: "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire." In Park & Tilford v. Schulte, 2 Cir., 160 F.2d 984, we held that the exercise of an option to acquire securities was a "purchase" within this section and § 16(b). In Falco v. Donner Foundation, Inc., 2 Cir., 208 F.2d 600, we affirmed this view and expressly stated that the time when the alleged insider's rights and obligations became fixed was controlling in the application of the statute. See also 59 Yale L.J. 510, 520; 65 Harv.L.Rev. 997.

In the face of these authorities plaintiff's argument remains unclear. He clings doggedly to the fact that payment and passage of title constituted execution of the

contract, and that the inclusion of executory transactions does not import the exclusion of executed ones. Certainly this is so, but it does not blunt the statutory mandate of our prior holdings where a choice between executory and executed dates is required. Nor can it justify finding two "purchases" where in fact but one exists.

The reasoning behind our earlier rulings is sound. It matters not to the speculator who has title or possession or who can vote the stock or receive dividends. What he needs is firm assurance that a fixed quantity can be acquired or disposed of at a fixed price; and his commitments are on that basis. And speculation, actual or potential, is the only vice within the purview of § 16(b). Other possible abuses of stock options do not now concern us.

Since the only "purchase" before us took place in 1945, and no sale ensued until 1948, there has been no short-swing transaction within the statutory prohibition. Hence whatever the profits, they are not recoverable for the corporation under this statute.

Affirmed.

Appendix D

EXCERPTS FROM SEC RELEASES

Securities Exchange Act Release No. 116 (1935), 11 Fed. Reg. 10968, §241.116:

• • •

The Commission also made public the substance of another opinion rendered by its General Counsel, regarding the time at which changes in ownership are considered to occur for the purpose of reports required of directors, officers, and principal stockholders under Section 16(a) of the Securities Exchange Act.

"In my opinion an officer, director, or stockholder is to be deemed to have acquired beneficial ownership of a security at the time when he takes a firm commitment for the purchase thereof, and to divest himself of such beneficial ownership at the time when he takes a firm commitment for the sale thereof. If it is necessary that certain conditions be satisfied prior to the consummation of the purchase or sale, and if it is uncertain whether such conditions will be satisfied, then it would appear that the officer, director, or stockholder would not acquire beneficial ownership, or divest himself thereof, until such time as such conditions are satisfied and the undertaking to purchase or sell becomes a firm commitment."

Securities Exchange Act Release No. 1571 (1938), 11 Fed. Reg. 10969, §241.1571:

The Securities and Exchange Commission today made public an opinion of the Director of its Trading and Exchange Division, Ganson Purcell, addressed to the New York Stock Exchange. The opinion was written in response to inquiries from the Exchange regarding a circular which the Exchange has prepared for its members giving certain instructions and interpretations of the Commis-

sion's rules on short selling. The texts of the opinion and of the circular of the New York Stock Exchange follow:

February 4, 1938

New York Stock Exchange
11 Wall Street
New York City

Attention: Dean K. Worcester, Esq.
Executive Vice-President

Gentlemen:

Representatives of your Exchange have discussed with me various problems concerning the operation of Rules X-3B-3, X-10A-1 and X-10A-2, relating to short-selling of securities, adopted by the Commission January 24, 1938. They have also submitted to me a draft of a circular proposed to be distributed among the membership of your Exchange, embodying comments and instructions regarding Exchange transactions under these rules, together with interpretations of certain provisions thereof. I understand that this circular is designed to facilitate operation under the rules.

The interpretations proposed to be included in this circular have been the subject of discussion between the Exchange representatives and the staff of the Trading and Exchange Division. As a result of these discussions a revised draft of the circular has been made. I have considered this revision, as it appears in the enclosed copy, and am of the opinion that the interpretative material contained therein is correct and in accordance with the underlying intent of the rules.

If at any time, you have any further questions with respect to the operation of these rules, I shall be glad to receive them and to discuss them with you.

Very truly yours,
Ganson Purcell,
Director.

NEW YORK STOCK EXCHANGE
Office of The Secretary
February 2, 1938

TO THE MEMBERS OF THE EXCHANGE:

Under date of January 24, 1938, the Securities and Exchange Commission promulgated rules X-3B-3, X-10A-1 and X-10A-2 relative to short selling. * * *

The following comments and interpretations of these rules are intended for the guidance of members and their customers. The Director of the Trading and Exchange Division of the Securities and Exchange Commission has advised the Exchange that in his opinion these comments and interpretations are correct.

1. *General Rule.* In general, the rule prohibits any "short sale" of a security, by the use of any facility of any national securities exchange, at or below the last regular way sale price of such security on such exchange. A "short sale" is defined as (1) any sale of a security which the seller does not own; or (2) any sale which is consummated by the delivery of a security borrowed by or for the account of the seller. * * *

* * *

5. *Ownership of Securities.* A person is deemed to own a security if (1) he or his agent has title to it; or (2) he has purchased or has entered into an unconditional contract, binding on both parties, to purchase it but has not yet received it; or (3) he owns a security convertible into or exchangeable for it and has tendered such security for conversion or exchange; or (4) he has an option to purchase or acquire it and has exercised such option; or (5) he has rights or warrants to subscribe to it and has exercised such rights or warrants. He is not deemed to own a security if he owns securities convertible into or exchangeable for it but has not tendered such securities for

conversion or exchange, or if he has an option or owns rights or warrants entitling him to such security, but has not exercised them.

* * *

ROBERT L. FISHER,
Secretary.

Appendix E

CASES UNDER §16(b) DECIDED SINCE 2 LOSS, SECURITIES REGULATION (2d ed. 1961, SUPP. 1962) c. 6C

B. T. Babbitt, Inc. v. *Lachner*, 332 F.2d 255 (2d Cir. 1964)

Baldwin-Montrose Chemical Co. v. *Rothberg*, CCH Fed. Sec. L. Rep. ¶¶91,217, 91,290, 91,347 (S. D. N. Y. 1963-64)

Booth v. *Varian Associates*, 334 F.2d 1, App. A *supra* (1st Cir. 1964)

Franklin v. *Blaylock*, 218 F. Supp. 261 (S. D. N. Y. 1963), *mandamus denied* sub nom. *Blaylock* v. *McLean*, 319 F.2d 534 (2d Cir. 1964)

Fuller v. *Dilbert*, 32 F. R. D. 60 (S. D. N. Y. 1962)

Gilson v. *Chock Full O'Nuts Corp.*, 326 F.2d 246, *rehearing en banc*, — F.2d —, CCH ¶91,362 (2d Cir. 1964)

Heli-Coil Corp. v. *Webster*, 222 F. Supp. 831 (D. N. J. 1963)

Kornfeld v. *Eaton*, 327 F.2d 263 (2d Cir. 1964)

Lewis v. *Shaffer Stores Co.*, CCH ¶¶91,223, 91,376 (S. D. N. Y. 1963-64)

Max Factor & Co. v. *Blau*, CCH ¶91,359 (S. D. Cal. 1964)

Miller v. *General Outdoor Advertising Co., Inc.*, 223 F. Supp. 790 (S. D. N. Y. 1963)

Molybdenum Corp. of America v. *International Mining Corp.*, 32 F. R. D. 415 (S. D. N. Y. 1963)

Nedick's Stores, Inc. v. *Genis*, 34 F. R. D. 235 (S. D. N. Y. 1963)

O'Neill v. *Maytag*, CCH ¶91,372 (S. D. N. Y. 1964)

Perfect Photo, Inc. v. *Grabb*, 205 F. Supp. 569 (E. D. Pa. 1962)

Perfect Photo, Inc. v. *Sentiff*, 205 F. Supp. 574 (E. D. Pa. 1962)

Polaroid Corp. v. *Casselman*, 213 F. Supp. 379 (S. D. N. Y. 1962)

Rosenfeld v. *Richardson*, CCH ¶91,176 (S. D. N. Y. 1962)

Rothenberg v. *Sonnabend*, CCH ¶91,226 (S. D. N. Y. 1963)

Sher v. *Johnston*, 216 F. Supp. 123 (S. D. N. Y. 1963)